Foreign Exchange by David Goldman

European strikes sustain dollar

But BIS data show enormous potential weakness if other currencies or interest rates rise.

Despite Bundesbank intervention in the spot and (reportedly) the forward foreign exchange markets, the dollar rose strongly April 19 just before markets closed for the Easter holiday, to DM 2.6750, from DM 2.6420 the previous day.

Considering the sharp rise of dollar interest rates during the past month, the dollar's rise—which retraces about one-third of its decline against the West German mark—is less than spectacular. Some published reports attribute the Thursday rise to the Commerce Department's allegation that Gross National Product rose at an 8.2% annual rate during the first quarter. That is nonsense. The big drop in March housing starts, auto sales, retail purchases and other indicators make clear that the recovery mirage is fading away.

Conventional explanations no longer work. Interest rates, particularly on the long-term side, should have fallen in response to the "bad economic news" earlier in the week, instead of rising, as they did. The dollar should have fallen, according to conventional wisdom.

Our basic analysis as of January stands: with 40% of the U.S. budget deficit financed by foreign capital inflows, the dictates of America's creditors in Europe and elsewhere will force up interest rates on the government bonds sold to them, or lower their price in terms of foreign currency (i.e., the dollar will fall).

However, Western Europe is in the middle of an enormous strike wave which has hardly begun to peak. Soviet involvement is obvious rather than covert. The British Tavistock Institute, the British intelligence psychological warfare command center for social control techniques, predicted earlier this year that Europe is moving into a period similar to 1974. During that year every European government was brought down by the strike activity.

In France, unemployment has grown by 10.4% in the past five months alone, and the government has just announced a series of industrial "restructurings" that is already threatening the shutdown of the Lorraine steel belt.

France's economic climate has worsened with the publication of the first quarter external payment figures, which are 15 billion French francs in the red, compared to a 5 billion franc plus in the last quarter of 1983. A 19 billion franc trade deficit and the quarterly payments on debt service account—widely expected to hit 60 billion francs this year, $7.5 billion—caused the swelling of the deficit.

In Germany, the situation is set to explode, following the failure of the metalworkers' contract negotiations.

In Italy, the Communist Party's ongoing nation-wide strike and demonstration activity continues unabated, making the country nearly ungovernable.

None of these developments aided the European currencies.

Nonetheless, the latest data made available by the Bank for International Settlements (BIS) on international bank lending show how vulnerable the dollar is to a decline against other currencies, or a sharp rise in interest rates, or both.

American banks borrowed from the Eurodollar market at a $53 billion annual rate during the third quarter of 1983; during the fourth quarter, the BIS data show, this rose to an $80 billion annual rate. Indeed, the United States borrowed half of the total $40 billion increase in Eurodollar loans during the quarter.

Previously, the U.S. was living off flight capital from Latin America and portfolio investment from Europe to finance its budget deficit; for the past 10 months, it has been living off credit from the Eurodollar market!

This explains why a "scissors" opened up in January on the financial markets, between rising interest rates and a weak dollar, i.e., higher interest rates no longer automatically attracted capital flows. The plain fact is that the capital flight into the United States bankrupted Latin America and threw Europe into depression, provoking the present strike wave, among other evil consequences.

The scissors will widen during the second quarter, although it is difficult to tell how much of the gap will be registered respectively in the interest rate and the exchange rate.

So far, the slaughter in the fixed-income securities markets has taken the pressure off the exchange rate. If the Soviets continue to press their destabilization of Western Europe, it is not possible to predict currency movements at all; Europeans will move funds into dollars regardless of the dollar's price.

However, the form of the Soviet destabilization is important; Soviet-backed European moves to dump the dollar as a trading unit for Western Europe could push the dollar over the edge.

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